



July 25, 2006

**SUBJECT:** Adoption of Emergency Ordinance and Introduction of Non-Emergency Ordinance Amending Chapter 3.12 of the Sunnyvale Municipal Code Regarding the Utility Users Tax for Intrastate Telephone Communications Services

**REPORT IN BRIEF**

Since 1969, the City of Sunnyvale has imposed a Utility Users Tax (UUT) on every person in the City using *intrastate* telephone communications services, subject to certain exemptions. Since 1975, the tax has been 2% of charges billed. The tax application has been consistent with the Internal Revenue Service's interpretation of the Federal Excise Tax (FET), a tax imposed on local and long distance services. As a result of a Treasury Department notice issued on May 25, 2006, the Internal Revenue Service (IRS) will no longer apply the FET to long distance and *bundled* service, effective July 31, 2006, as more fully described below.

In order to administratively clarify the City's intention of continuing its longstanding application of the UUT to intrastate telephone communications services as interpreted by the IRS' FET application prior to the May 2006 notice, staff recommends that Council adopt an emergency ordinance and introduce a non-emergency ordinance to make such clarifications to the Sunnyvale Municipal Code. These clarifications will allow the City to continue to apply the UUT as it has done historically. Failure to make this clarification could result in loss to the City of more than \$1 million in annual funding for essential services including public safety.

**BACKGROUND**

Since 1969, the City has applied its UUT consistent with the Internal Revenue Service's historical interpretation of the FET application to local and long distance telecommunications services. Over the past two years, several federal circuit courts of appeals ruled that the FET may not be imposed on long distance service unless charges for the calls are based on both time *and* distance. As telecommunications technology has evolved over time, many long distance telephone calls are not based on distance and others are not based on time, rendering obsolete the definition of "toll telephone service" in the Internal Revenue Code.

On May 25, 2006, the Treasury Department issued Notice 2006-50 to concede the legal dispute and announced that as of July 31, 2006, the IRS would no longer impose the FET on time-only long distance services and, although not required by the federal court decisions, the FET would no longer be imposed on bundled service. Bundled service is local and long distance service provided under a single plan that does not separately state the charges for local telephone service. This is a reversal from previous IRS rulings that imposed the FET on long distance calls based on either time or distance, which Sunnyvale has relied upon as a guideline in applying its UUT to intrastate service. In order to clarify that the City will continue to apply the UUT to intrastate telecommunications services consistent with the IRS interpretation on FET application prior to May 25, 2006, staff is recommending the Council adopt an emergency ordinance and introduce a non-emergency ordinance to amend Chapter 3.12 of the Sunnyvale Municipal Code.

#### **EXISTING POLICY**

Legislative Action Position 7.1.(18): Oppose actions by the federal or state government that would reduce or erode local revenues.

#### **DISCUSSION**

In order to continue to apply the UUT to intrastate telephone communications services, it is necessary to amend Chapter 3.12 of the Sunnyvale Municipal Code to clarify that the City wishes to continue its longstanding tax application and does not wish to adopt the new IRS interpretation of FET application. This will allow the City to continue to impose the UUT as it has historically done.

It is important to note that these ordinance clarifications do not in any way change the basis/methodology of calculating the tax, nor should they be construed as imposing a new tax, or extending or increasing an existing tax. The ordinance amendments simply clarify that the City will continue its longstanding tax application based on the IRS' interpretation of the FET guideline prior to issuance of Notice 2006-50 on May 25, 2006.

Sunnyvale receives approximately \$1.6 million in annual revenue from the UUT on intrastate telephone communications services. If the City applied the UUT consistent with Notice 2006-50, the FY 2006/2007 revenue could precipitously decline by approximately 65%-75%, or more than \$1 million. In order to preserve this critical revenue stream, staff recommends adoption of the proposed emergency ordinance, per City Charter Section 701. An emergency ordinance may be adopted by Council at the meeting in which it is introduced if the action is necessary to preserve the public peace, health or safety, and if passed by at least five (5) affirmative votes. The loss of more than \$1 million in annual UUT revenue would have an immediate and adverse impact on

essential City services, including public safety. Staff also recommends that Council introduce a non-emergency ordinance that will be adopted by a second reading on August 8, 2006.

### **FISCAL IMPACT**

Should the Council adopt the proposed emergency ordinance and introduce a non-emergency ordinance to amend Chapter 3.12 of the Sunnyvale Municipal Code, no fiscal impact would occur. If the Council chooses not to adopt the ordinances, an annual revenue loss of more than \$1 million would occur.

### **CONCLUSION**

In order to preserve the City's substantial UUT revenue from intrastate telephone communications services, it is necessary to amend Chapter 3.12 of the Sunnyvale Municipal Code to clarify that the City wishes to continue its longstanding tax application based on the IRS' interpretation of the FET guideline prior to issuance of Treasury Department Notice 2006-50 on May 25, 2006.

### **PUBLIC CONTACT**

Public contact was made through posting of the Council agenda in public places, on the City's web page, and the publication of the Council agenda in the San Jose Mercury News and the availability of the report in the Library and the City Clerk's Office.

### **ALTERNATIVES**

1. Adopt the emergency ordinance and introduce the non-emergency ordinance amending Chapter 3.12 of the Sunnyvale Municipal Code.
2. Do not adopt the emergency ordinance and do not introduce the non-emergency ordinance amending Chapter 3.12 of the Sunnyvale Municipal Code.

### **RECOMMENDATION**

Staff recommends Alternative 1.

Prepared by:

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Pete Gonda  
Senior Management Analyst, Finance

Reviewed by:

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Mary J. Bradley  
Director of Finance  
Reviewed by:

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David Kahn  
City Attorney

Approved by:

Amy Chan  
City Manager

**Attachments**

- A. An Emergency Ordinance of the City Council Amending Chapter 3.12 of the Sunnyvale Municipal Code Pertaining to Utility Users Tax on Intrastate Telephone Communications Services and Setting Forth the Facts Constituting Such Emergency
- B. An Ordinance of the City Council Amending Chapter 3.12 of the Sunnyvale Municipal Code Pertaining to Utility Users Tax on Intrastate Telephone Communications Services

ORDINANCE NO. \_\_\_\_\_

AN EMERGENCY ORDINANCE OF THE CITY OF CITY COUNCIL  
OF THE CITY OF SUNNYVALE AMENDING CHAPTER 3.12 OF  
TITLE 3 OF THE SUNNYVALE MUNICIPAL CODE PERTAINING  
TO UTILITY USER TAX ON INTRASTATE TELEPHONE  
COMMUNICATION SERVICES AND SETTING FORTH THE  
FACTS CONSTITUTING SUCH EMERGENCY

WHEREAS, since 1969, the City of Sunnyvale has imposed a utility user tax on every person in the City using intrastate telephone communication services; and

WHEREAS, the City's utility users tax on intrastate telephone communication services has been applied consistent with the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS); and

WHEREAS, on May 25, 2006, the Treasury Department announced in Notice 2006-50 that effective August 1, 2006, it will no longer apply the FET to long distance and bundled long distance and local service provided under a single plan that does not separately state the charges for local telephone service; and

WHEREAS, the Treasury Department's Notice 2006-50 reversed its prior Revenue Rulings and interpretation of the FET, which the City has relied upon in applying its utility users tax on intrastate telephone communication services; and

WHEREAS, by the adoption of this Ordinance amending the utility users tax on intrastate telephone communication services, the City reaffirms that it will continue its long-standing practice of applying its utility users tax on telephone communication services in a manner consistent with the IRS' interpretation of the FET which was in effect prior to the issuance of Notice 2006-50 on May 25, 2006.

NOW, THEREFORE, BE IT ORDAINED by the City Council of the City of Sunnyvale as follows:

Section 1. Section 3.12.030 (11) of Chapter 3.12 of Title 3 of the Sunnyvale Municipal Code is amended to read as follows:

(11) “Telephone communication services” means “communication services” as defined in Sections 4251 and 4252 of the Internal Revenue Code and the regulations thereunder, as those Sections were interpreted by the Internal Revenue Service before May 25, 2006, and shall include any telephonic quality communication that is interconnected to a public switched network, and shall include, without limitation, transmissions (including but not limited to, voice, telegraph, teletypewriter, data, facsimile, video or text) by electronic, radio, or similar means through “interconnected service” with the “public switched network,” as these terms are commonly used in the Federal Communications Act, 47 U.S.C.A. Section 332(d) and the regulations of the Federal Communications Commission, whether such transmission occurs by wire, cable, fiber-optic, light wave, laser, microwave, radio wave, including, but not limited to cellular service, commercial mobile service, personal communications service (PCS), specialized mobile radio (SMR), and other types of personal wireless service telecommunications (see 47 U.S.C.A. Section 332(c)(8)(C)(i), regardless of the radio spectrum used, switching facilities, satellite or any other similar facilities.

Section 2. Section 3.12.070 of Chapter 3.12 of Title 3 of the Sunnyvale Municipal Code is amended to read as follows:

(a) There is hereby imposed a tax upon every person, other than a telephone corporation, using intrastate telecommunication services in the city. The tax imposed by this section and Sections 3.12.080 through 3.12.100 shall be at the rate of two percent of the charges made for intrastate telephone communication services, and shall be collected from the service user by the telephone communication services provider or its billing agent. To the extent allowed by law, the tax on intrastate telephone communication services shall apply to a service user if the billing or service address of the service user is within the city’s boundaries. If the billing address of the service user is different from the service address, the service address of the service user shall be used.

(b) “Telephone communications services” shall not include “private mobile radio service,” as defined in Part 20 of the Title 47 of the Code of Federal Regulations, or “private mobile service,” as defined in 47 U.S.C.A. Section 332 (d), which is not interconnected to a public switched network. The tax imposed under this chapter shall not be imposed upon any person for using intrastate telephone communication services to the extent that pursuant to Sections 4252 and 4253 of the Internal Revenue Code, the amounts paid for such communication services are exempt from or are not subject to the tax imposed under Section 4251 of the Internal Revenue Code, as those sections were

interpreted by the Internal Revenue service before May 25, 2006. . In the event that the federal excise tax on “communications services” as provided in Sections 4251, 4252, and 4253 of the Internal Revenue Code is subsequently modified, repealed, any reference in this Chapter or in any administrative ruling to such law, including any related federal regulations, private letter rulings, case law, and other opinions interpreting these sections, shall refer to that body of law as those sections were interpreted by the Internal Revenue Service prior to May 25, 2006. ~~that existed immediately prior to the date of repeal as well as to any judicial or administrative decision interpreting such federal excise tax law which is published or rendered after the date of repeal.~~

(c) The tax administrator may, from time to time, issue and disseminate to telecommunication service suppliers, which are subject to the tax collection requirements of this chapter, an administrative ruling identifying those telecommunications services that are subject to taxation under this chapter. These administrative rulings shall remain in effect unless altered or amended by the tax administrator and these administrative rulings shall continue to be consistent with applicable legal requirements, including any federal excise tax rules, regulations, and laws pertaining to “communications services” as interpreted by the Internal Revenue service before May 25, 2006.

(d) As used in this section, the term “charges” shall also include the value of any other services, credits, property of every kind or nature, or other consideration provided by the service user in exchange for the telecommunication services including (i) all monthly recurring charges for calling features purchased by the user; (ii) monthly service charges for services including foreign exchange service; (iii) charges for special listings in the white pages of the telephone directory; (iv) charges for non-published (unlisted) numbers; (v) directory assistance charges; (vi) message unit or zone rate charges; (vii) repair charges; and (viii) toll or long distance messages. If a non-taxable service and a taxable service are billed together under a single charge, the entire charge shall be deemed taxable unless the service provider can reasonably identify charges not subject to the utility users tax based upon its books and records that are kept in the regular course of business, which shall be consistent with generally accepted accounting principles.

(e) As used in this section, the term “charges” shall not, however, include:

- (i) customer deposits;
- (ii) directory (Yellow Pages) advertising;
- (iii) rental or sale of directories, reverse directories;
- (iv) all charges for maritime mobile services as defined in Section 2.1 of Title 47 of the Code of Federal Regulations;
- (v) private line service charges;
- (vi) PBX charges (excluding trunk charges);
- (vii) all charges made for Universal Life Line services, and
- (viii) services paid for by inserting coins in coin-operated telephones.

Section 3. Section 3.12.080 of Chapter 3.12 of Title 3 of the Sunnyvale Municipal Code is amended to read as follows:

Notwithstanding the provisions of Section 3.12.070, the tax imposed under Sections 3.12.070 through 3.12.100 shall not be imposed upon any person for using telecommunication services to the extent that the amounts paid for such services are exempt from or not subject to the tax imposed under Section 4251 of the Internal Revenue Code, as that Section was interpreted by the Internal Revenue Service before May 25, 2006, or under Part 20 (commencing with Section 41001) of Division 2 of the California Revenue and Taxation Code, and the regulations thereunder, except for the following charges, which are taxable under this section:

(a) Charges to a service user by a hotel or motel for intrastate telecommunication services used in the city when such charges are incidental to the right of occupancy in such hotel or motel. Collection of the tax shall be the responsibility of the hotel or motel; and

(b) Charges to a service user in the city by a telecommunication services provider, including but not limited to an alternative or nontraditional telephone service provider, a private communication service provider, or a competitive access provider, for providing intrastate telecommunication services used in the city.

Section 4. If this Ordinance is declared to be invalid, then the provisions of Chapter 3.12 as that Chapter read on July 24, 2006 will become effective.

Section 5. This Ordinance shall not be construed as imposing a new tax, extending or increasing an existing tax.

Section 6. This Ordinance is declared by the City Council to be an emergency measure necessary for the immediate preservation of public peace, health or safety. The facts constituting such urgency are as follows: The revenues from the utility users tax on intrastate telephone communications services are anticipated to be approximately \$1.6 million dollars for Fiscal Year 2006-2007 if the telephone users tax is applied consistent with the IRS' interpretation of the FET prior to the issuance of Notice 2006-50. In the event that the City's telephone users tax were to be applied consistent with Notice 2006-50, it is projected that the total utility users tax from intrastate telephone users tax revenues could decrease by up to \$1.2 million dollars for Fiscal Year 2006-2007. The revenues from the utility users tax on intrastate telephone communications services are critical to the public peace, health or safety in that these revenues pay the costs associated with essential services, including public safety.

Section 7. This Ordinance shall become effective immediately upon its adoption



pursuant to Section 701 of the Charter of the City of Sunnyvale, and shall remain in effect until the effective date of the superseding Ordinance.

Adopted as an ordinance at a regular meeting of the City Council held on this July 25, 2006, by the following vote:

AYES:	SPITALERI, HOWE, LEE, SWEGLES, HAMILTON, CHU, MOYLAN
NOES:	None
ABSTAIN:	None
ABSENT:	None
ATTEST:	APPROVED:

\_\_\_\_\_  
City Clerk  
(SEAL)

\_\_\_\_\_  
Mayor

APPROVED AS TO FORM AND LEGALITY:

\_\_\_\_\_  
David E. Kahn, City Attorney

ORDINANCE NO. \_\_\_\_\_

AN ORDINANCE OF THE CITY OF CITY COUNCIL OF THE CITY  
OF SUNNYVALE AMENDING CHAPTER 3.12 OF TITLE 3 OF THE  
SUNNYVALE MUNICIPAL CODE PERTAINING TO UTILITY  
USERS TAX ON INTRASTATE TELEPHONE COMMUNICATION  
SERVICES

WHEREAS, since 1969, the City of Sunnyvale has imposed a utility users tax on every person in the City using intrastate telephone communication services; and

WHEREAS, the City's utility users tax on intrastate telephone communication services has been applied consistent with the application of the Federal Excise Tax (FET) upon local and long distance telecommunication services as the FET is interpreted by the Internal Revenue Service (IRS); and

WHEREAS, on May 25, 2006, the Treasury Department announced in Notice 2006-50 that effective August 1, 2006, it will no longer apply the FET to long distance and bundled long distance and local service provided under a single plan that does not separately state the charges for local telephone service; and

WHEREAS, the Treasury Department's Notice 2006-50 reversed its prior Revenue Rulings and interpretation of the FET, which the City has relied upon in applying its utility users tax on intrastate telephone communication services; and

WHEREAS, by the adoption of this Ordinance amending the utility users tax on intrastate telephone communication services, the City reaffirms that it will continue its long-standing practice of applying its utility users tax on telephone communication services in a manner consistent with the IRS' interpretation of the FET which was in effect prior to the issuance of Notice 2006-50 on May 25, 2006.

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(b) “Telephone communications services” shall not include “private mobile radio service,” as defined in Part 20 of the Title 47 of the Code of Federal Regulations, or “private mobile service,” as defined in 47 U.S.C.A. Section 332 (d), which is not interconnected to a public switched network. The tax imposed under this chapter shall not be imposed upon any person for using intrastate telephone communication services to the extent that pursuant to Sections 4252 and 4253 of the Internal Revenue Code, the amounts paid for such communication services are exempt from or are not subject to the tax imposed under Section 4251 of the Internal Revenue Code, as those sections were

interpreted by the Internal Revenue Service prior to May 25, 2006. In the event that the federal excise tax on “communications services” as provided in Sections 4251, 4252, and 4253 of the Internal Revenue Code is subsequently modified ~~repealed~~, any reference in this Chapter or in any administrative ruling to such law, including any related federal regulations, private letter rulings, case law, and other opinions interpreting these sections, shall refer to that body of law as those sections were interpreted by the Internal Revenue Service prior to May 25, 2006. ~~that existed immediately prior to the date of repeal as well as to any judicial or administrative decision interpreting such federal excise tax law which is published or rendered after the date of repeal.~~

(c) The tax administrator may, from time to time, issue and disseminate to telecommunication service suppliers, which are subject to the tax collection requirements of this chapter, an administrative ruling identifying those telecommunications services that are subject to taxation under this chapter. These administrative rulings shall remain in effect unless altered or amended by the tax administrator and these administrative rulings shall continue to be consistent with applicable legal requirements, including any federal excise tax rules, regulations, and laws pertaining to “communications services” as interpreted by the Internal Revenue Service before May 25, 2006.

(d) As used in this section, the term “charges” shall also include the value of any other services, credits, property of every kind or nature, or other consideration provided by the service user in exchange for the telecommunication services including (i) all monthly recurring charges for calling features purchased by the user; (ii) monthly service charges for services including foreign exchange service; (iii) charges for special listings in the white pages of the telephone directory; (iv) charges for non-published (unlisted) numbers; (v) directory assistance charges; (vi) message unit or zone rate charges; (vii) repair charges; and (viii) toll or long distance messages. If a non-taxable service and a taxable service are billed together under a single charge, the entire charge shall be deemed taxable unless the service provider can reasonably identify charges not subject to the utility users tax based upon its books and records that are kept in the regular course of business, which shall be consistent with generally accepted accounting principles.

(e) As used in this section, the term “charges” shall not, however, include:

- (i) customer deposits;
- (ii) directory (Yellow Pages) advertising;
- (iii) rental or sale of directories, reverse directories;
- (iv) all charges for maritime mobile services as defined in Section 2.1 of Title 47 of the Code of Federal Regulations;
- (v) private line service charges;
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- (vii) all charges made for Universal Life Line services, and
- (viii) services paid for by inserting coins in coin-operated telephones.

Section 3. Section 3.12.080 of Chapter 3.12 of Title 3 of the Sunnyvale Municipal Code is amended to read as follows:

Notwithstanding the provisions of Section 3.12.070, the tax imposed under Sections 3.12.070 through 3.12.100 shall not be imposed upon any person for using telecommunication services to the extent that the amounts paid for such services are exempt from or not subject to the tax imposed under Section 4251 of the Internal Revenue Code, as that Section was interpreted by the Internal Revenue Service before May 25, 2006, or under Part 20 (commencing with Section 41001) of Division 2 of the California Revenue and Taxation Code, and the regulations thereunder, except for the following charges, which are taxable under this section:

(a) Charges to a service user by a hotel or motel for intrastate telecommunication services used in the city when such charges are incidental to the right of occupancy in such hotel or motel. Collection of the tax shall be the responsibility of the hotel or motel; and

(b) Charges to a service user in the city by a telecommunication services provider, including but not limited to an alternative or nontraditional telephone service provider, a private communication service provider, or a competitive access provider, for providing intrastate telecommunication services used in the city.

Section 4. If this Ordinance is declared to be invalid, then the provisions of Chapter 3.12 as that Chapter read on July 24, 2006 will become effective.

Section 5. This Ordinance shall not be construed as imposing a new tax, extending or increasing an existing tax.

Adopted as an ordinance at a regular meeting of the City Council held on this August 8, 2006, by the following vote:

AYES: SPITALERI, HOWE, LEE, SWEGLES, HAMILTON, CHU, MOYLAN  
NOES: None  
ABSTAIN: None  
ABSENT: None  
ATTEST: APPROVED:

\_\_\_\_\_  
City Clerk  
(SEAL)

\_\_\_\_\_  
Mayor

APPROVED AS TO FORM AND LEGALITY:

\_\_\_\_\_  
David E. Kahn, City Attorney